

**STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES**

**In The Matter Of The Competitive Service :
Offerings Of Elizabethtown Gas Company : BPU Docket No. GA02020099**

**COMMENTS OF
NUI UTILITIES, INC. D/B/A
ELIZABETHTOWN GAS COMPANY**

In accordance with the schedule adopted by the Staff of the Board of Public Utilities (“Board” or “BPU”), NUI Utilities, Inc. d/b/a Elizabethtown Gas Company (“Elizabethtown” or “Company”) hereby submits its comments concerning the “Audit Of Competitive Service Offerings Of Elizabethtown Gas Company” (“Audit”) submitted by Overland Consulting and dated March 14, 2003.

Summary Of Comments

From Elizabethtown’s perspective, the Audit contains a number of useful recommendations that the Company is willing to implement in order to ensure that its affiliate relationships comply with applicable law (including the relevant provisions of the Electric Discount and Energy Competition Act (“EDECA”)¹) and the Board’s regulations governing certain affiliate relationships as set forth in *N.J.A.C. 14:4-5.1 et seq.* With certain limited modifications, Elizabethtown believes that it would be appropriate for the Board to require the Company to adopt recommendations A.1, A.2, A.3, A.4 (partially), B.2 (partially), B.4, B.5 (partially), E.1 (partially), and F.1 (partially). At the same time, as more fully discussed below, Elizabethtown believes that the Board should reject or substantially modify recommendations B.1, B.3, C.1, D.1, E.2 and E.3.

Elizabethtown recognizes that the Board possesses broad powers to audit the Company's books and records.² However, the Board's authority is not open-ended.³ To the extent that the

¹ *N.J.S.A. 48:3-49 et seq.*

² *N.J.S.A.* 48:2-16.1.

³ See e.g. *In re N.J. Am. Water Co.*, 169 N.J. 181 (2001) ("... a court will not sustain an action by the BPU ... when that action is found to be 'arbitrary, capricious, unreasonable, or beyond the agency's delegated powers.'");

Board wishes to adopt Audit findings that rely on findings concerning contested issues of material fact, the Board should afford the affected parties the right to a trial type hearing.⁴ As more fully discussed below, a number of the recommendations contained in the Audit are predicated upon findings of fact that are disputed by the Company and would require a trial-type hearing. Accordingly, to the extent that the Board determines that these recommendations should be considered in this proceeding, Elizabethtown requests the Board to establish a hearing to address these matters. In addition, Elizabethtown submits that to the extent that the recommendations reflected in the Audit contemplate that the Board should adopt generic standards that either augment or revise the Board's current regulations governing affiliate relationships, the Board should proceed to adopt such standards through the rulemaking procedures required by the State Administrative Procedure Act.⁵

Finally, Elizabethtown would note that it is aware that the auditors were given a limited period of time in which to complete the Audit. As a consequence, while Elizabethtown believes that the Audit contains a number of erroneous assumptions and/or factual misstatements, the Company will focus only on those statements or assumptions that affect a recommendation with which Elizabethtown disagrees. Elizabethtown believes that factual misstatements concerning recommendations that the Company will agree to implement represent harmless errors.⁶

Set forth below are Elizabethtown's comments concerning the specific recommendations set forth in the Audit:

Greater Boston Television Corp. v. F.C.C., 444 F.2d 841, 852 (D.C. Cir. 1970), *cert. denied.*, 403 U.S. 923 (1971)("An agency changing its course must supply a reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored . . .").

⁴ *N.J.S.A. 52:14B-1, et seq.*; *N.J.S.A. 52:14B-9*; *N.J.S.A. 48:2-16.1*.

⁵ *N.J.S.A. 52:14B-4*; *see also Metromedia, Inc. v. Director, Bd. Of Taxation*, 97 N.J. 313 (1984).

⁶ However, Elizabethtown reserves the right to contest any factual material contained in the Audit to the extent that it may be used for any purpose other than implementing the Audit's recommendations.

A.1 Prepare monthly or quarterly itemized statements of inter-company services and charges (including allocations) for review by the business units and departments being charged for the services.

Elizabethtown is willing to implement this recommendation on a quarterly basis.

A.2. Develop service agreements to describe the nature, terms and prices to be charged for inter-company services.

Elizabethtown is willing to implement this recommendation for all affiliates providing services to Elizabethtown and will include such agreements in a compliance filing following a final Board order concerning the audit.

A.3. Enhance the applicability of Elizabethtown's "Asset Transfer, Leases and Rentals" policy to all inter-company transactions and affiliates.

Elizabethtown is willing to implement this recommendation for all affiliates providing service to Elizabethtown.

A.4. Develop an inter-company transaction procedure that provides for monthly settlement of amounts owed by affiliates to one another. Investigate and clear the existing large, unsettled inter-company receivables and payables balances that have accumulated over the years.

The Company agrees to revise its procedures for the accounting for inter-company balances and to close out the balances in the various inter-company accounts. The Company does not, however, agree that it is necessary to research existing balances, other than where any differences may exist between net balances on each business unit's books.

NUI Corporation's ("NUI") accounting policy has been to view all net inter-company balances at the end of each accounting period as obligations to NUI. Essentially, that means that the net of all the balances for each business unit is treated as a note payable to or receivable from NUI. This has the same effect as closing out and settling inter-company balances each month. Requiring NUI to investigate the details of prior balances would provide no benefit.

B.1. Adopt an attributable cost basis for allocating the common costs of NUIHQ departments and Elizabethtown Gas departments providing shared utility services. Whenever possible, identify employee efforts benefiting subsidiaries using time sheets.

Elizabethtown disagrees with the Audit's recommendation with regard to the allocation of common costs. Elizabethtown's cost allocation procedures have been in effect since 1994 when they were filed in response to the Board's order approving NUI's merger with Pennsylvania and Southern Gas Company.⁷ Under the Company's policy, costs that can be directly associated with particular business units are charged to those business units. In addition, where the Company has identified specific cost causation factors associated with expenses of shared services departments, costs are assigned on the basis of those factors. Costs that cannot be directly associated with particular business units or specific cost causation factors are allocated to all business units benefiting from the incurrence of the costs by means of a three factor formula which gives equal weighting to gross plant, payroll and number of customers. The Company has consistently opposed the use of timesheets or cumbersome and arbitrary ongoing analyses of shared services costs as a basis for cost allocation, because it has never been demonstrated that the benefits of such activities would outweigh the costs and administrative burdens.

When the Company's cost allocation policy was filed in 1994, Staff and the Division of the Ratepayer Advocate were afforded the opportunity to challenge the policy. However, ultimately no changes were made. Since 1994, the Company has followed its cost allocation policy, and costs allocated in accordance with the policy were reflected in base rate cases filed in New Jersey and Florida. Neither the Florida Public Service Commission nor the Board found the policy to be unreasonable or required any adjustment to it.

While the Audit characterizes the three factors reflected in the cost allocation methodology as "arbitrary," Elizabethtown disagrees. The three factors chosen as the basis for allocation of common costs reflect the key measures of the size and scope of the various businesses served by the common service providers. The physical size of the business is

⁷ *Re Elizabethtown Gas Company*, Docket No. GM93090390, Slip. Op. (Apr. 19, 1994).

measured by gross plant, business generation is measured by the number of customers, and the size of the operations is measured by payroll. These key elements are commonly used to allocate income for taxation by many states, including New Jersey, with the only difference in New Jersey being that revenues are used instead of numbers of customers.

While the auditors attempt to show that Elizabethtown's three factor methodology is arbitrary by comparing the results of Elizabethtown's methodology to the results obtained using an alternative three-factor methodology based on employees, operating revenues and operating expenses,⁸ this analysis proves nothing. Obviously, any formula that bases two-thirds of an allocation on revenues and operating expenses will tend to allocate more costs to high volume/high cost businesses such as NUI's energy trading business, which has large operating expenses (gas costs) and large revenues (payments for gas costs). Moreover, the auditors identify no jurisdiction that uses the three factors reflected in the alternative methodology.

While the auditors further criticize the use of a gross plant factor in Elizabethtown's cost allocation formula,⁹ they ignore the fact that the size and extent of a business entity's plant surely affects its need for such shared corporate services as Purchasing, Tax Administration, Public Relations, Accounting and Legal and Regulatory Affairs. Moreover, the auditors completely ignore the facts that (1) gross plant is one of the factors utilized by the Federal Energy Regulatory Commission to allocate corporate overheads to interstate natural gas pipelines,¹⁰ and (2) Jersey Central Power and Light Company uses gross plant factor to allocate common costs.¹¹

The auditors' further criticisms of Elizabethtown's use of a customer factor are equally unavailing. While the auditors cite to the fact that NUI Energy Brokers' customers contribute far more margin per customer than Elizabethtown's customers, it is not clear why this information is relevant or meaningful. Obviously, NUI incurs far more shared services costs to administer Elizabethtown's 250,000-plus customers than NUI does to administer Energy Brokers' 106

⁸ See Audit at 3-6 and 3-7.

⁹ Audit at 3-6.

¹⁰ See, e.g., *Enbridge, Pipelines*, 100 FERC ¶ 61,260 (2002); *Northwest Pipeline Corporation*, 87 FERC ¶ 61,266 (1999); *Paiute Pipeline Company*, 76 FERC ¶ 61,114 (1996).

¹¹ *In Re Jersey Central Power & Light Co.*, OAL Docket No. PUC661-92.

customers. It is, or should be, readily apparent that the large differences in the number of customers should justify a significant difference in the allocation of shared services costs. Certainly, the number of customers served by various entities affects their incurrence of shared services costs to a far greater degree than the level of margin generated.

Under the auditors' recommendation, Elizabethtown would be required to substitute a so-called "attributable" cost allocation methodology for its current methodology. The auditors' cost allocation recommendation is modeled on cost allocation standards adopted by the Federal Communications Commission ("FCC") to apportion costs between regulated and non-regulated telephone business activities.¹² While the auditors' suggest that their recommended approach has been adopted by "most regulatory commissions," Elizabethtown is aware of only one instance in which a state regulatory commission has applied this model outside the telephone industry.¹³ Moreover, the Board has never developed or required the State's energy utilities to develop a uniform methodology for allocating costs. Rather, the test has been whether the methodology adopted produces reasonable results. While the Board has determined implicitly that Elizabethtown's current methodology produces reasonable results, there is no basis in the Audit for the Board to conclude that the methodology recommended by the auditors would produce such results.

Under the auditors' recommendation, Elizabethtown would be required to implement potentially costly and administratively burdensome procedures to enable employees with responsibilities for areas such as human resources to track and record their time. There is no evidence that the benefits of this extensive costs tracking effort would outweigh the costs. Moreover, intuitively, one would expect that the results of an extensive cost tracking effort would produce results that are not markedly different than those produced by the application of the Company's cost allocation formula. For example, with respect to human resources, under the application of the three-factor formula, approximately 60% of NUI's total costs will be allocated

¹² 47 C.F.R. § 64.901.

¹³ See, e.g. *Northern Utilities, Inc.*, 2003 Me PUC LEXIS 3, 19 (January 3, 2003).

to Elizabethtown during the current fiscal year. Given the number of Elizabethtown's employees relative to NUI's other operations, it is certainly reasonable to conclude that, over time, NUI will devote approximately 60% of its human resources efforts to Elizabethtown matters. While the use of time sheets might establish that in certain periods more effort is devoted to NUI's operations in some other state, there is no reason to believe that such a relationship would continue over the long term. Moreover, there is no basis to conclude that incurring the costs associated with monitoring the tracking of time and lost employee productivity associated with regular timekeeping would provide any meaningful benefit.

Elizabethtown recognizes that there are numerous ways to allocate costs and that the Board may wish to consider adopting a generic approach for allocating costs among the State's energy utilities. If the Board wishes to adopt a generic methodology, it should do so through a proper rulemaking procedure¹⁴ in which the costs and benefits of various approaches may be properly evaluated. Accordingly, assuming that the Board believes that the auditors' recommendation provides a basis to consider requiring Elizabethtown to change its existing methodology, it should, at most, defer the auditor's recommendation pending the outcome of a generic proceeding.

B.2. Implement management accounting procedures to fully allocate all common costs attributable to a Business Unit to its individual departments.

The Company agrees that it is appropriate to include all costs associated with a shared services function in the total expenses that are allocated for that function. However, the Company does not believe that it is feasible to use the three-factor method to allocate shared services costs to responsibility centers, since the three factors – plant, payroll and customers -- are not all present at the responsibility center level. The Company would agree to develop a procedure to assign all allocated costs to all shared services responsibility centers using the specific allocation factors where appropriate (e.g., square footage for facilities costs), or a

¹⁴ *Metromedia, Inc. v. Director, Bd. Of Taxation, supra.*

common factor, such as direct operating expenses, for other costs. Elizabethtown will submit a proposal concerning this recommendation in its compliance filing in this proceeding.

B.3. Limit Elizabethtown's charge for the direct and NUIHQ – allocated rental costs of the Union facility to the market prices for efficiently used space in the facility.

Elizabethtown submits that this recommendation should be rejected for several reasons. First, this recommendation is well beyond the scope of the Audit. The Audit states that the Board's affiliate standards formed the basis for audit compliance testing.¹⁵ However, Elizabethtown's relationship with the Liberty Hall Joint Venture ("LHJV") is not subject to regulation under the Board's affiliate regulations. The LHJV does not provide competitive services to retail customers in New Jersey. Moreover, under EDECA, the LHJV is neither a "related competitive business segment of an electric public utility or gas public utility" or a "related competitive business segment of a public utility holding company." Given these facts, there is no reason why issues related to rent paid by NUI for its Union headquarters should be the subject of the Audit.

Second, the auditors' conclusion that Elizabethtown is paying rent in excess of market levels is wholly unsupported. In this regard, contrary to the auditor's claim,¹⁶ NUI does not pay \$45 per square foot for its Union headquarters building. Rather, NUI currently pays approximately \$30 per square foot for that space.

The auditors' claim that the current market price for space in the Union headquarters is approximately \$29 per square foot is based on an analysis of the rents paid by sub-tenants of NUI. Elizabethtown notes that the auditors do not claim to possess any qualifications to determine the market value of rental property. Moreover, the market rents paid by subtenants of Elizabethtown are the product of market conditions that existed at the time the subtenants entered into leases with NUI and the terms and conditions of those subleases. There is no relationship

¹⁵ Audit at 1-1.

¹⁶ For fiscal year 2003, Elizabethtown projects that it will incur total costs of \$5,942,000 for its Union headquarters space. Total costs include base rental costs, building operating costs and real estate taxes. Elizabethtown's total costs are divided by the rentable square feet (194,732) in the Union headquarters to yield a total cost per square foot of \$30.51.

between these market conditions and the conditions faced by NUI at the time that it negotiated and subsequently amended its Union headquarters lease. If the Board wishes to draw any conclusion about the reasonableness of the rents paid by NUI under its lease, it is the market conditions faced by the Company at the time the Company entered into and restructured its lease that the Board should examine, not the market conditions faced by subtenants.

In addition, while the auditors take issue with NUI's decision to renegotiate and extend its lease of the Union facility in the Year 2000, the auditors make no effort to determine whether NUI benefited from this transaction or was justified in proceeding with it. Instead, the auditors focus on the benefits that the auditor's claim the LHJV realized from the transaction.¹⁷ In considering the auditors' recommendation, Elizabethtown submits that the Board must focus on the costs and benefits of the Union headquarters' lease to NUI, not the costs and benefits to the LHJV.

In this regard, Elizabethtown and LHJV entered into a lease for 160,000 square feet of space in the Union headquarters in 1987 for a primary term of 20 years. The original lease was approved by the Board (even though the Board determined that no such approval was required),¹⁸ and costs incurred under the lease were subsequently reflected in Elizabethtown's rates.¹⁹ Under the terms of the lease, the rent paid by Elizabethtown was subject to a variety of escalations that were beyond the Company's control. For example, under the original lease Elizabethtown was responsible for paying 80% of the operating costs of the building, but did not have the ability to determine how those costs were incurred. Over the course of the lease, this issue became an increasing point of contention between NUI and LHJV. In order to resolve this and other issues prospectively,²⁰ NUI agreed to amend its lease with the LHJV. Under the terms

¹⁷ Audit at 3-9, 3-10.

¹⁸ *I/M/O The Petition of Elizabethtown Gas Company for Approval of a Lease Agreement With Liberty Hall Joint Venture*, BPU Docket No. GO87081011 (December 9, 1987).

¹⁹ *I/M/O The Petition of Elizabethtown Gas Company for Approval of Increased Base Tariff Rates And Charges For Gas Service and Other Tariff Revisions*, BPU Docket No. GR88121321 (February 1, 1990).

²⁰ NUI and the LHJV are engaged in litigation over operating expenses related to the prior lease arrangement. The LHJV has sued NUI for \$170,000 of operating expenses, claiming breach of contract. NUI has counterclaimed for an amount in excess of \$800,000. The matter is pending. The conduct of this contentious litigation should eliminate any doubt that NUI's relations with the LHJV are not conducted at arms length.

of the revised lease, Elizabethtown was able to reduce its base rent from \$20.33 per square foot to \$15.95 per square foot and obtain control of the incurrence of operating costs. In return, NUI extended the lease through 2022 and agreed to lease the entire building.²¹ The net effect of this transaction was that NUI was able to realize an immediate reduction in the net costs of the Union building of more than \$1 million per year.

While the auditors take issue with the fact that NUI renegotiated its Union lease at a time when the Company was also reducing its presence in the Union building, the auditors fail to recognize that NUI's decision to reduce the number of employees headquartered in the Union building was part of an overall strategy to consolidate operations. As the auditors recognize, at NUI's other headquarters facility in Bedminster, its costs per square foot are lower²² than at the Union facility. At the same time, NUI has been able to obtain sublease rents for portions of the space in Union that are greater than its costs of leasing space in Bedminster. Thus, even after considering the fact that NUI is not able to obtain sublease rents that fully recover the costs of the Union space, the net impact of NUI's decision to relocate employees and sublet a larger portion of the Union facility is to save money.

Elizabethtown submits that its efforts to consolidate operations and restructure its facilities arrangements have reduced costs that would otherwise be incurred by its customers and shareholders. Elizabethtown's efforts have not been limited solely to its Union headquarters space, but have also included the closing of its Woodbridge service facility and the relocation of its call center operation. These efforts are the reason that Elizabethtown has been able to hold operation and maintenance expense increases to an annual level of approximately 1.5% over the past twelve years, a level that is significantly less than the rate of general inflation.

While the auditors take issue not only with the rent paid by Elizabethtown, but also with the fact that NUI occupies more space per employee in Union than it does in Bedminster, the

²¹ There are approximately 207,000 square feet of space in the building. Of this amount, a little over 12,000 square feet is associated with mechanical rooms and the cafeteria. Thus, the building contains approximately 195,000 rentable square feet.

²² See Audit at 3-12.

auditors ignore the fact that the Union facility provides conference room space that is regularly used for the purposes for which it was intended. NUI's Bedminster facility does not include comparable conference room space. The auditors also ignore the fact that a portion of the space that was considered to be unoccupied during the audit period was associated with NUI's ongoing consolidation of operations. Elizabethtown believes that it is quite common to vacate space while consolidating operations. This does not mean that the space will not be used in the future or that the costs of the space should be accounted for below the line. NUI's leases with the subtenants at the Union facility are designed to enable NUI to reclaim the space on relatively brief notice. Thus, to the extent that NUI believes that it is in its best interest to relocate certain employees to Union, such relocations can be effectuated quickly.

The auditors' recommendation that Elizabethtown should be required to account for a portion of its space costs below the line is not consistent with applicable Board precedent. In the Company's 1988 rate case, a portion of Elizabethtown's costs of its Union headquarters was not included in rates because the space represented expansion space that Elizabethtown intended to sublet for the then-foreseeable future. While costs of the unused space were not included in rates, the Board did not require Elizabethtown to account for the costs of the space below the line as the auditors recommend here. Rather, the Board determined, as it should here, that the costs incurred by the Company for its expansion space were properly included on Elizabethtown's books for accounting purposes.

Assuming that the Board believes that the Company's accounting for the costs of its Union headquarters is within the scope of this Audit, Elizabethtown proposes that the Audit recommendation be revised to require Elizabethtown to separately identify (1) its charges for direct and NUIHQ-allocated rental space, (2) any NUI affiliate's charges for space, and (3) any costs that are allocated to NUI as a result of assessing sublease rents that do not recover the embedded costs of the sublet space. This information would enable the Board to evaluate the reasonableness of any facilities' costs that the Company could seek to recover in rates at the time that the issue becomes relevant. This is a far better approach than imposing an ongoing duty on

the Company to determine “the market price for efficiently used space” or to account for its lease costs below the line.

B.4. Charge the Market Rental Value of the Rahway operations center to the ASB.

To the extent that the ASB continues to occupy the Rahway facility, Elizabethtown will charge an appropriate rent to the ASB. However, Elizabethtown does not agree with the Audit’s conclusion that the failure to charge the costs of this facility to the ASB represents a cross-subsidy of the ASB by Elizabethtown.²³ Whether cross-subsidization occurs can only be determined by consideration of the total costs allocated between two entities. In other words, an under-allocation of certain costs from one entity to another may be offset by an over-allocation of other costs. As discussed more fully below, Elizabethtown is currently evaluating its appliance service rates and will make a determination concerning those rates in the near future.

B.5. Obtain support to enable an attributable cost-based allocation of corporate liability, property and workers compensation insurance.

The Company agrees with the underlying principle of allocation of insurance costs based upon cost causation. In fact, significant changes have been made to the Company’s risk management policies and procedures since the audit data was gathered. Specifically, NUI reorganized its risk management function, which included changes in (1) the department responsible for the risk management and insurance functions, (2) the means of handling those functions, (3) the cost allocation processes referenced in the draft report, and, (4) in some cases, the information provided to the Company by certain of its insurance carriers which facilitate the analysis of claims data and/or insurance costs.

When insurance premiums are competitively bid out (as are all of the Company’s), the Company provides each of the carriers with data regarding the Company, each of its business units, and loss history. The insurance company reviews all of this information, assesses the respective risks of each business unit, and computes a premium, based primarily upon the insurance company’s assessment of the related risks. When the insurance company breaks out

²³ See Audit at 1-6.

the premium based upon its assessment of the related risks, there is no allocation – this is the actual cost of the insurance determined upon the basis of an arms-length negotiation, which is then directly assigned to the business unit that created the cost.

While Elizabethtown appreciates the auditors' desire to review the back-up information, supporting the insurers' allocations, in certain instances obtaining such information will increase Elizabethtown's costs. Elizabethtown agrees that it will attempt to obtain back-up data where it is cost effective to do so.

C.1. Recalculate floor prices based on fully allocated New Jersey ASB costs. Update tariffed appliance service prices based on recalculated floor prices.

Contrary to the Audit's finding, NUI's floor prices for appliance services are not several years old.²⁴ NUI filed an application to establish the initial floor price for its appliance service offerings on June 9, 2000 in accordance with the applicable provisions of EDECA. The Company received authorization to implement its appliance service offerings at hourly rates approved by the Board and its Staff on August 15, 2001.²⁵ The Company was directed to file tariffs reflecting the pricing and service offerings and complied accordingly.

There are numerous cost methodologies and formulae which may be employed to determine the appropriate pricing of appliance service products. The methodology employed by the Company was accepted by the Staff and found by the Board to support the fully allocated cost of providing the services. Under Section 10 of EDECA, the Board is afforded discretion to determine whether a particular cost allocation methodology results in fully allocated costs.²⁶

During the period the application was pending at the Board, the Bureau of Audits conducted a competitive services audit of the Company and reviewed the Company's floor price information and recommended only that the Company include technician travel time in its pricing. *Schumacher REC. VI-5 at p.53*. Since the Company has now separated the appliance

²⁴ Audit at 1-11.

²⁵ *I/M/O The Petition Of NUI Elizabethtown Gas Company For Approval To Establish A Floor Price Hourly Rate For Appliance Service Contract And Non-Contract Services And To Implement New Electric Central Air Conditioning Services*, Docket No. GR00060385.

²⁶ *N.J.S.A.* 48:3-58.

service technicians from the utility, this recommendation no longer applies because technicians now perform all their work either for the utility or the competitive service segment of the utility. There is no splitting of time between the two business segments.

The Company is currently evaluating whether it needs to make a filing to update its floor prices for appliance services. At such time as it makes such a filing, it would be proper for the Board to evaluate whether Elizabethtown's current methodology for allocating costs to the appliance service business should be modified. Elizabethtown already recognizes that the costs of the Rahway facility used by the ASB should be reflected in its allocated costs. Moreover, the ASB now has its own call center. However, until a complete floor price filing is made, summary modifications to the Company's formula based upon the auditors' subjective recommendations are not appropriate.

D.1. Because Energy Brokers acts as a procurement agent for ETG, the inter-company service agreement between ETG and Energy Brokers should include terms prohibiting Energy Brokers from selling gas or gas transportation to ETG except in emergency circumstances and prohibiting Energy Services from profiting from such transactions.

In fiscal 2002, Elizabethtown purchased a small portion of its supplies (1.73%) from Energy Brokers. These purchases result primarily from Energy Brokers' participation in competitive, blind, on-line reverse auctions. These auctions are conducted by a third party under a process in which pre-qualified sellers bid against each other to offer the lowest price to the buyer. The auction is blind, meaning the sellers are unaware of the identities of the other sellers. Once the auction is completed, the buyer has 15 minutes to accept the best bid. The process ensures that the buyer receives the lowest price available at the time of the auction.

There is no reason why Energy Brokers should be prohibited from participating in the auction process or prohibited from deriving a profit to the extent it participates in such process. Prohibiting Energy Brokers from participating will only result in increases in gas costs to Elizabethtown's customers by limiting Elizabethtown to higher cost options. Moreover, all such purchases can be reviewed by the Board in Elizabethtown's annual Basic Gas Supply Service

proceeding. Under these circumstances, there is no reason why the Board should impose a blanket prohibition on Energy Brokers' sales to Elizabethtown.

E.1 UBS should support all professional services charged to NUI with timesheets describing the service performed and the amounts of time required to perform them. NUI Utilities should enter into an agreement each budget year describing the services UBS will provide and the amounts required to fund them. NUI Utilities should not incur the costs of UBS professional services that cannot be billed to third-parties in the market place. UBS should retain all unchargeable costs on its own books. Until this occurs, the Board should consider requiring Elizabethtown to record all charges for UBS's Operations and Applications Services department below-the-line to avoid ratepayer cross-subsidization [Findings 6-11-D, 6-11-F].

While Elizabethtown does not object to requiring UBS's Operations and Applications Services ("OAS") department use timesheets to support its billings to Elizabethtown where appropriate, the Company does not agree with the unsubstantiated claim that there is ratepayer cross-subsidization of UBS or the suggestion that Elizabethtown should record all charges from UBS' Operations and Applications Services ("OAS") group below-the-line. UBS performs billing and engineering functions for Elizabethtown that are essential to the operations of Elizabethtown. The engineering services performed by the OAS group include facility mapping, hydraulic modeling, network planning, and engineering studies and other special projects, carried out at the request of Elizabethtown. Examples of special projects OAS has undertaken at Elizabethtown's request are meter reading cycle re-routing and the automation of a paper field sheet system. OAS does not perform services of this scope on behalf of third party clients. With respect to billing services, the functions performed by UBS for Elizabethtown include bill printing and stuffing, customer payment processing, and operation of the mainframe computer, on which multiple utility applications are run.

During the course of each annual budget process, UBS reviews its proposed service charges in detail with Elizabethtown, documenting, for example, the calculation of the billing services per-bill charge by function. UBS and Elizabethtown agree upon a per-bill rate for the fiscal year. As stated in the Audit, "A comparison of per-bill prices UBS charged to Elizabethtown and to external customers suggests that billing and remittance processing is not

being cross-subsidized by Elizabethtown.”²⁷ A similar process takes place between Elizabethtown and OAS, in which services are requested and charges are reviewed and agreed upon at the start of each fiscal year.

Elizabethtown takes exception to the assertion that it incurs costs from UBS that “cannot be billed to third-parties in the market place.” The only support provided for this contention is the observation that the amounts charged to NUI Utilities exceed the charges to third parties. The auditors assert that the relatively higher share of revenue from NUI Utilities “indicates a possibility” that NUI Utilities is subsidizing OAS. In fact, the scope of services provided to third-parties is not comparable to the services provided to Elizabethtown. For example, OAS provides Elizabethtown with extensive network analysis services which are generally not provided to other entities. Elizabethtown only pays UBS for essential services necessary to provide natural gas distribution service to its customers, and these costs are properly recorded on Elizabethtown’s books. UBS is confident that its charges to Elizabethtown are lower than costs that Elizabethtown would incur for comparable services purchased in the marketplace.

E.2. ETG should not record the costs of UBS development efforts in its regulated accounts. The Board should consider requiring NUI Utilities to identify and credit Elizabethtown Gas for the costs of the WINS Fieldbook, a UBS digital mapping application UBS sells to third parties, that Elizabethtown Gas helped pay to develop. The Board should also consider prohibiting Elizabethtown from funding UBS’s product development efforts.

Elizabethtown objects to this recommendation because it is predicated upon a factual finding that has not and cannot be substantiated. Elizabethtown does not fund UBS’s development efforts. Rather, it purchases certain services from UBS that are necessary to enable Elizabethtown to perform its distribution functions. In the case of the WINS-CIS system, UBS had developed a simplified billing system for NUI’s Pennsylvania, New York and North Carolina gas distribution systems. When Elizabethtown began the process of replacing its CSS system, it utilized UBS to assist in the development of specifications for a replacement customer system and to explore whether the system developed for the other utility systems could be

²⁷ Audit at 6-2.

upgraded to meet Elizabethtown's needs. When UBS and Elizabethtown determined that the existing system could not be upgraded sufficiently, the effort was abandoned. Nonetheless, Elizabethtown retained the specifications developed in conjunction with UBS and will utilize those specifications in its ongoing effort to replace its existing system. Thus, Elizabethtown did not fund the development of a WINS-CIS system for UBS's benefit; it funded the development of specifications for replacing Elizabethtown's CIS system for Elizabethtown's benefit.

Similarly, with respect to the WINS-Fieldbook, Elizabethtown requested UBS to develop certain applications to be utilized by Elizabethtown. UBS developed these individually-tailored applications at cost. Moreover, while UBS continues to make enhancements to the WINS-Fieldbook, Elizabethtown does not continue to pay UBS for the Fieldbook that has been developed to date. While it is correct that UBS has since sold modified versions of the WINS-Fieldbook to other clients, Elizabethtown cannot be said to have paid for the development of the specific products that were sold to other clients. Rather, the entities that have purchased these versions have paid for the applications they require. Moreover, these entities generally pay UBS a licensing fee for the ongoing use of the product. Elizabethtown pays no such fee.

The evidence cited by the auditors in support of the claim that Elizabethtown paid to develop the WINS-Fieldbook consists solely of an article in a Company newsletter and a journal entry that suggests that costs were charged to Elizabethtown.²⁸ This evidence proves nothing. At most, it can be said to create an issue. There is certainly no basis in the Audit to require Elizabethtown to write off the costs of an asset that it uses in its ongoing engineering operations. Indeed, even if it could be shown that Elizabethtown's costs for the WINS-Fieldbook were in excess of market costs (which has not been shown), such a showing would only justify requiring the Company to absorb the difference between the total costs and the market price; not the entire total cost as suggested by the Auditors.

²⁸ Audit at 6-12.

E.3. The BPU should carefully consider NUI’s interpretation that UBS is not a “retail” affiliate subject to the BPU standards.

The sole basis for the auditor’s recommendation that UBS should be considered a retail affiliate under the BPU’s regulations is the auditors’ belief that Board Staff views Millenium, a provider of wholesale meter reading services owned jointly by South Jersey Industries, Inc. (“South Jersey”) and Connectiv Solutions, as a retail affiliate subject to the Board’s Affiliate Regulations. Based on the auditor’s unsubstantiated conclusion that UBS and Millenium are similar to one another, the Audit recommends that UBS also be treated as a retail affiliate within the meaning of the Board’s Affiliate Regulations.

Preliminarily, while Elizabethtown is only generally familiar with Millenium, from what Elizabethtown understands Millenium and UBS are factually distinct entities. It is Elizabethtown’s understanding that Millenium provides wholesale meter reading services solely to affiliated utilities. UBS provides wholesale billing and engineering services to both affiliated and non-affiliated utilities, a distinction noted in the Audit.²⁹ Thus, Millenium and UBS are discernibly different from one another with regard to the services they provide and the entities they serve. But even if Millenium and UBS are similar, the Board has never, to Elizabethtown’s knowledge, found that Millenium is a retail affiliate subject to the Affiliate Regulations.

The Board adopted the Affiliate Regulations pursuant to EDECA and limited the applicability of these Regulations to public utility affiliates providing or offering competitive services to retail customers in New Jersey.³⁰ UBS cannot be considered an entity which provides service to retail customers. While the Affiliate Regulations do not define retail, under accepted definitions, a retail sale is one where the product or service is provided to the ultimate consumer and is not resold.³¹ The billing and engineering services provided by UBS to Elizabethtown and other utilities are utilized by these entities to provide other services to the ultimate customers –

²⁹ Audit at 1-14.

³⁰ *N.J.S.A.* 48:3-58k(1); *N.J.A.C.* 14:4-5.1(a).

³¹ See *N.J.S.A.* 54:32B-2(e); *Fairlawn Shopper, Inc. v. Director, Division of Taxation*, 98 N.J. 64, 71 (1986); *GNOC, Corp. v. Director, Division of Taxation*, 167 N.J. 62, 63; *Webster’s New Collegiate Dictionary* (1976) (defining the noun retail as the sale of commodities or goods in small quantities to ultimate consumers). It also defines the adjective retail as of, relating to, or engaged in the sale of commodities at retail.

the utilities' customers. UBS has no contractual relationship or communication with retail customers.

If it is the Board's intent to expand the scope of its existing Affiliate Regulations to include wholesale service providers on an industry-wide basis or to treat UBS alone as a retail service provider, it may only do so in compliance with the State Administrative Procedure Act.³² However, Elizabethtown can think of no reason why the Board should expand the reach of its regulations and the Audit provides no such reason.

F.1. NUI should immediately complete an inventory of all telecommunications facilities and services it uses and purchases from Telecom. This inventory should be reconciled with currently unidentifiable charges on bills from Telecom. Telecom should identify all telecommunications facilities and services passed through from other carriers and billed to NUI with an NUI business unit, department, geographic location and description of the service or facility provided. Until this is done, Telecom should cease billing NUI for unidentified amounts (or, at a minimum, to avoid ratepayer cross-subsidization, ETG should stop recording allocations of such charges above the line).

Contrary to the auditor's conclusion, NUI has completed an inventory of services and facilities purchased from NUI Telecom. In addition, NUI also reconciles the bills assessed by Telecom to NUI including the so-called miscellaneous charges. For whatever reason, this has not been adequately communicated to the auditors. Accordingly, NUI agrees that it will implement the recommendation to identify NUI Telecom's charges by business unit, department and location and will provide the material which demonstrates how this is being done, and will continue to be done, in its compliance filing.

³² *N.J.S.A. 52:14B-1, et seq.; N.J.S.A. 52:14B-4; N.J.S.A. 52:14B-9; see also Metromedia, Inc. v. Director, Bd. Of Taxation*, 97 N.J. 313 (1984).